

USAID/Indonesia

Annual Report

FY 2004

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Indonesia

Performance:

Background: Six years into a comprehensive political and economic transition, Indonesia has made significant progress in consolidating democratic reforms and processes, successfully converting from one of the world's most centralized countries to one of the most decentralized, and getting the country's economy back on a growth path. It is beginning to tackle terrorism.

In 2003, positive trends toward economic recovery continued. A bullish stock-market and stable currency have helped Indonesia to attain a gross domestic product growth officially somewhere below 5%, while inflation remains within the 6-7% target range. In a sign of improving confidence, Moody's Investors Service and Fitch recently upgraded Indonesia's credit rating.

In preparation for its graduation from the IMF economic policy package at the end of 2003, Indonesia published a "White-Paper" of key economic policies and reforms. It aims to ensure continued macroeconomic stability and progress with lower interest rates and risk premiums to attract higher foreign direct investment, economic growth and a strong financial sector. At the recently concluded annual donors meeting of the Consultative Group on Indonesia (CGI), International Donors pledged US\$3.4 billion for project and program loans, export and investment credit guarantees, and grants.

Since January 2002, Indonesia has been undergoing a process of decentralization by which authority and resources are being devolved from the central government to more than 400 local governments. Changes were introduced through a "big-bang" approach in which the devolution of authority was transferred virtually overnight. Through this process, administrative responsibilities for over two million civil servants, almost two-thirds of the government workforce, were transferred to the local level. Contrary to predictions of a national breakdown, the transfer of authority has been relatively successful. However, local governments are now accountable for the provision of essential services such as education and health care to their citizens. Most are still ill-prepared to address the challenges of planning, budgeting, and managing these services in an effective, transparent and accountable manner.

Indonesian democracy continues to be challenged by the lack of an effective, predictable, transparent and equitable justice sector. Corruption is endemic and the political will to implement real and sustainable reforms remains uncertain. As a result of the failure of its legal institutions, businesses as well as individuals have continued to suffer through arbitrary and irrational court judgments, which affect both commercial and civil proceedings.

The challenges and opportunities presented by Indonesia's rapid decentralization process continued to confront health sector service delivery in 2003. There were 360 designated district governments at this time last year, today there are over 440, each struggling to ensure that basic services are adequately planned, budgeted, delivered, and monitored. While national Indonesia Demographic and Health Survey (IDHS) health statistics for 2002-2003 are very encouraging given the political, economic, and governance turmoil of the past five years, great regional disparities persist. Provincial-level data indicate that significant disparities in health sector performance remain in less populated, more remote outer islands.

Indonesia has shown increasing signs of commitment in the war on terrorism since the Bali bombing in October 2002 and subsequent J.W. Marriott Hotel bombing in August 2003. In September 2003 the Parliament amended its law on money laundering to tighten procedures on financial transfers, bringing them into compliance with international standards. This was followed by the introduction of the Financial Transaction and Report Analysis Center (PPATK) as the highest authority to combat financial crimes,

reporting directly to President Megawati Soekarnoputri. In addition to enhancing collaborative efforts with their American and Australian counterparts, these efforts/changes allowed Indonesia to avoid sanctions by the OECD Financial Action Task Force on Money Laundering.

In the fight against sectarian, interethnic and separatist violence, 2003 proved to be a mixed year. The overall number of Internally Displaced Populations (IDPs) during the reporting period is down from 1.3 million to 600,000. Many areas throughout Central Sulawesi and the Mulukas, which have been wracked by Muslim-Christian infighting, passed through a phase of relative stability. In late fall of 2003, however, flare-ups were again reported in Central Sulawesi and neighboring areas. The failure of the Aceh province peace process resulted in the declaration of martial law in May of 2003. The Indonesian Army has blocked foreign organizations (including humanitarian aid workers) from entering the province while the death toll of this separatist conflict continued to mount. There were also increasing reports of sporadic fighting between local militias and the Indonesian military in Papua.

Challenges: Despite continued progress on many fronts, numerous challenges remain that could derail what is still a fragile situation. The education system is in crisis. Indonesia continues to struggle in overcoming deeply entrenched legacies of authoritarian rule. Indonesia is the only major ASEAN country yet to fully recover from the 1997-1998 Asian Financial Crisis. Decentralization shifted responsibility for the delivery of essential human services to more than 400 local governments, most of which are ill-prepared to address the challenges of planning, budgeting, and managing these services in an effective, transparent and accountable manner. More than 40 million people live in poverty with limited access to adequate health services, food, clean water and effective sanitation. An estimated 77 million people (one-third of the population) lack access to clean water. Hundreds of thousands of Indonesians continue to suffer from ethnic and religious conflict and natural disasters.

U.S. interests and goals: As the world's largest Muslim-majority country, Indonesia is too important to fail. The outcome of Indonesia's democratic transition has profound implications for U.S. strategic interests in fighting terrorism; preserving regional stability in Asia; strengthening democratic principles, the rule of law and respect for human rights; and expanding access for U.S. exports and investment in the fourth largest country in the world. Indonesia's importance also stems from its substantial natural resources, rich biodiversity, and strategic location across key shipping lanes linking Europe, the Middle East, and Asia. A thriving Indonesian democracy could serve as an example and inspiration to other Muslim nations with a long experience of autocratic rule.

Equally key to Indonesia's importance to U.S. interests are the attendant risks of its failure as a state. The failure of Indonesian democracy would likely fuel the argument of radicals, in Indonesia and throughout the Muslim world, that the concept of democracy is inimical to Islamic values and that an Islamic state is the only answer. A breakdown in law and order could accelerate the spread of terrorism, crime, illegal drugs, infectious diseases, such as HIV/AIDS, and trafficking in persons. Dissolution of central authority and rising separatist movements would destabilize the region, raise the risk of substantial humanitarian emergencies, and invite the growth of militarism and violence.

Through coordinated approaches and complementary programs, the Department of State and USAID work to strengthen Indonesia's role in the global coalition against terrorism and support its efforts to diminish the underlying conditions that terrorists seek to exploit; help American businesses succeed in the Indonesian market and create conditions for investment and trade that can lift millions out of poverty; support the transition from authoritarianism to democracy; promote respect for human rights; fight infectious diseases like HIV/AIDS; combat international crime including trafficking in persons; and continue to provide humanitarian relief services. Programs also support President Bush's transnational initiatives, including those on HIV/AIDS prevention, treatment and care, the Digital Freedom Initiative, and access to water.

Key Achievements: USAID's 2000-2004 assistance program to Indonesia was designed to support a transition from 1998-era crisis response initiatives to strategic interventions that established the foundation for priority economic, social and political reforms. This has largely been accomplished. Three years into the current country strategy, USAID assistance has resulted in numerous successes.

Examples include: the passage of constitutional amendments allowing for direct elections of the President and Vice President for the first time in Indonesia's history; achievement of annual IMF targets for bank and corporate debt restructuring; the reduction of massive energy subsidies easing pressure on the national budget; and enactment of critical new laws on money laundering and environmental protection.

Strengthening Local Government: USAID is recognized as a lead donor supporting decentralization and the development of effective local government. In 2003, USAID assistance directly impacted on nearly 100 Indonesian local governments. In Bekasi, over 100 million person-hours of commuting time were saved by retiming the traffic light system. This also reduced pollution from emissions and saved businesses money through reduced fuel expenditure, transportation and delivery times. Seven more failing water enterprises became profitable for the first time, bringing the total to 12 over three years. These enterprises were able to attract outside funding and add 135,000 new consumers, making a three-year total of 735,000. Despite rising electricity costs, tariff increases recommended and justified by USAID assistance reduced local government subsidies by more than \$2,000,000.

Strengthening Democratic Reform: USAID constitutional reform activities resulted in the completion of all substantive amendments and the appointment of a constitutional commission. The newly amended Constitution enshrines individual rights, regional autonomy and establishes a system of checks and balances. In the labor sector, a USAID partner organization won a landmark decision in Central Jakarta Court ordering the Government to uphold the safety and health of migrant workers ejected from Malaysia in 2002. With USAID assistance an improved electoral framework meeting international standards was established. USAID is the lead donor to the National Legislature, the National Election Authority and civil society advocacy organizations. As a result, a series of significant laws were established including new election laws for the legislative and first-ever presidential elections. USAID's strong focus on civil society advocacy in 2003 resulted in the training of more than 13,000 NGO and labor activists and community leaders. Organizations receiving such assistance had key input to over 35 bills or were instrumental in these bills becoming part of the legislative agenda.

Natural Resource Management: USAID assistance supported the implementation of seventy-three site-specific co-management plans, which placed nearly six million hectares of coastline and forest under better management and protection. In West Kutai (Mahakam River Delta watershed), the USAID-supported District Forest Management Plan, covering 1.6 million hectares, is being implemented by the new Advisory Board, which represents government, NGOs, and the private sector. As part of the new Management Plan, the West Kutai district government stopped the issuance of small-scale logging licenses, saving tens of thousands of hectares of primary forest.

Crisis Mitigation: In Jakarta, USAID provided a half million dollars of assistance to the survivors of the JW Marriott terrorist attack within one week of the tragedy. Following a public announcement by U.S. Ambassador Boyce, USAID immediately assessed key needs and implemented both direct assistance to survivors and support to critical first responders. USAID is also providing support for special burn garments and critical assets for a burn unit at a hospital serving the under-privileged. In 2003, USAID's P.L.-480 Title II food aid Transitional Activity Program (TAP), had a direct and significant impact on the health, productivity, and social stability of vulnerable populations in urban slums and rural areas. Over 23,400 MTs of commodities to more than 380,000 Indonesians was distributed.

Promoting Economic Growth: USAID key results in 2003 helped Indonesia to: 1) meet 2003 targets for asset recovery and corporate debt restructuring; 2) put into place critical amendments to laws, policies, and decrees on anti-money laundering, asset freezing, counter-terrorism, and mutual legal assistance; 3) take the important step towards getting the country off the Financial Action Task Force blacklist by assisting the Financial Transaction Report and Analysis Center to enforce the law on a jurisdiction wide basis; and 4) Establish the Indonesian Deposit Insurance Agency.

Energy Sector Reform: USAID helped Indonesia take another major step in 2003 towards the reduction of energy subsidies. A price increase of 11% for refined petroleum products and 26% in electricity tariffs saved the state budget approximately \$780 million. USAID technical assistance resulted in the GOI

drafting a Geothermal Law. Parliament has completed its deliberation in September 2003, and the Law is expected to be enacted in late 2003. USAID assistance resulted in the GOI developing numerous government regulations related to the Electricity Law passed in 2002.

Health, Population and Nutrition: A focus district in West Java, with a population of almost two million, re-allocated funds in June 2003 to improve delivery services and pneumonia management. Concurrently, USAID activities along with the Ministry of Health (MOH) established new drug procurement and distribution systems for national communicable disease programs. Particular emphasis was placed on the national TB Control Program. As a result TB drug combination packs and new fixed dose combination drugs are now available in the focus province. In four target districts, with a population of 7 million, USAID assistance provided training for village midwives to improve neonatal health practices. The commitment of USAID, its development partners and the Indonesian government resulted in a tremendous increase in births attended by health professionals. From 1997 to 2003, attendance in West Java increased from 30.5% to 48.6 %.

Next Steps: As a result of USAID/Indonesia's successes in under this strategy and evolving development needs, USAID is designing and will begin to implement a new strategic plan in the coming year. New assistance objectives and activities reflect a shift from central government partners and processes to more direct engagement with Indonesia's citizens, communities, private business sector and local governments.

Donor Relations: Donor relations are excellent. The United States is the second largest bilateral donor in Indonesia and the largest donor of grant assistance. Other major bilateral donors include Japan, the Netherlands, Australia, Germany, the United Kingdom, and Canada. Through flexible and responsive programming, USAID plays a leadership role among donors, most notably in elections assistance, civil society development, decentralization, forestry, and health and humanitarian assistance. USAID works closely with the major multilateral donors: the World Bank, the Asian Development Bank (ADB), the International Monetary Fund (IMF), the European Union, and United Nations agencies. The World Bank-chaired Consultative Group on Indonesia (CGI) coordinates donor assistance to Indonesia. The United Nations-led Partnership for Governance also coordinates donor interventions on civil society, corporate governance, anticorruption, decentralization, justice sector reform, and poverty reduction.

Country Close and Graduation:

Results Framework

497-007 Democratic Reforms Sustained and Deepened

SO Level Indicator(s):

- Citizen Satisfaction with Democracy
- Citizen Satisfaction with Key Institutions
- Key Legislative/Policy Breakthroughs as a Result of Civil Society Advocacy
- 7.1 Key National and Local Level Government Institutions Made More Responsive and Effective
 - 7.1.1 National Policy Making Processes Made More Responsive and Effective
 - 7.1.2 Local Legislatures in Selected Areas Made More Responsive and Effective
 - 7.1.3 Political Parties at National Level and in Selected Localities Made More Responsive and Effective
- 7.2 Increased Citizen Participation in Governance
 - 7.2.1 Civil Society Organizations' Impact on Policy Making and Implementation Increased
 - 7.2.2 Civil Society Organizations' Ability to Increase Citizen Participation in Governance Increased
 - 7.2.3 Increase Capacity of the Media to Inform Citizens About Key National and Local Issues
- 7.3 Capacity and Support for Justice Sector Reform Increased
 - 7.3.1 Constituencies for Justice Sector Reform Expanded and Strengthened
 - 7.3.2 Use of Legal Mechanisms to Redress Abuses of Power Increased

497-008 Health of Women and Children Improved

SO Level Indicator(s):

- Contraceptive Prevalence Rate (%)
- Proportion of Births Attended by a Skilled Provider (%)
- Vitamin A Capsule (VAC) Coverage (%)
- 8.1 Policy Environment for Reproductive and Child Health Improved
- 8.2 Health Service Strengthened to Improve Access, Quality and Sustainability
- 8.3 Women, Families and Communities Empowered to Take Responsibility for Improving Health

497-009 Impact of Conflicts and Crises Reduced

SO Level Indicator(s):

- Beneficiaries of Feeding Programs
- Commodities Distributed
- Person Days of Labor
- 9.1 Improved Welfare of Populations Affected by Natural or Man-made Disasters
- 9.2 Food Security for Vulnerable Populations Improved
- 9.3 Indigenous Efforts and Capacity to Resolve Conflict and Promote Reconciliation Strengthened

497-010 Decentralized and Participatory Local Government

SO Level Indicator(s):

- Number of Local Governments Using Improved Management Tools and Practices
- Number of Local Governments Using Participatory Medium-Term Planning
- Policy Reform Index
- 10.1 Appropriate Environment Established to Enable Effective Local Government
- 10.2 Local Government Capacity Strengthened to Deliver Effective Services
- 10.3 Participation Increased in Local Government Decision-making
- 10.4 Associations of Local Government and Officials Established as Advocates

497-011 Foundation Set for Rapid, Sustainable, and Equitable Economic Growth

SO Level Indicator(s):

- Cumulative Assets Sold under Bank Restructuring Agency (IBRA) (trillion Rp)
- Cumulative Number of Substantial Policy Engagements with Government or Parliament
- Non Oil and Gas Revenue from International Trade (billion US\$)
- Outstanding Loans by BR Village Unit (# of borrowers)

- 11.1 Sound Economic Policy and Institutions
- 11.2 A Conducive Legal and Regulatory Framework
- 11.3 Open Access to Economic Opportunity
- 11.4 Knowledgeable Public Participation in Economic Decision-making

497-012 Strengthened and Decentralized Natural Resources Management

SO Level Indicator(s):

- Number of Participants in USAID-assisted Trainings and Workshops
- Number of Publications Documenting Natural Resource Management Lessons Learned that Promote Replication
- Number of Site-specific Management Plans
- Number on Policy Advance Index
- 12.1 Roles and Responsibilities of Stakeholders for Natural Resource Decision-making and Management Clarified
- 12.2 Capacity of Local Stakeholders to Manage Natural Resource Improved
- 12.3 Broader and More Knowledgeable Public Demand for Sustainable Natural Resource Management Formed

497-013 Energy Sector Governance Strengthened

SO Level Indicator(s):

- Actual Emission Unit Reductions (million ton)
- Net Contribution to the Government of Indonesia from Energy Sector (million US\$)
- Number of Advances along the Policy Development and Enabling Regulation Index
- 13.1 Energy Sector Reform Implemented
- 13.2 Broader and More Knowledgeable Participation in Energy Sector Reform
- 13.3 Environmentally Friendly Investment in Management of the Energy Sector Increased

497-XXX State Dept & BHR Funds

497-YYY 498-009 U.S. - Asia Environmental Partnership (US-AEP)

497-ZZZ Improved Quality of Decentralized Basic Education